

1.7. CORPORATE GOVERNANCE IN FRANCE (2008-2016)

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1.7.1. Overview of the French Legal Framework of Corporate Governance

On the practical side, the AFG (Association Française de la Gestion Financière) defines corporate governance as a field that “focuses on the division of powers between various stakeholders, including company’s governance bodies, the board (board of directors or supervisory board) and shareholders, with the aim of ensuring a balance of power within a company. [It] encompasses the rights and obligations of corporate management with regard to the others stakeholders, as well as the mechanisms that the other stakeholders’ can use to control the activities of corporate management”²⁹.

The French legal framework will be detailed further in the corresponding parts, but very generally European countries have implemented reforms in the corporate governance field for the last twenty to twenty-five years for three main reasons (Enriques & Volpin, 2007):

1. To increase the attractiveness of their national markets;
2. To implement a common regulatory framework at the European level;
3. As part of a response to the many scandals of the 1990s and 2000s.

In France, these reforms have mostly focused on:

- The strengthening of internal governance mechanisms, in particular, to limit self-dealing and to improve board effectiveness.
- The increase in minority shareholders’ powers.
- The increase in disclosure requirements, in particular on general corporate governance issues, along with self-dealing and insider, compensation, and financial reporting and audit issues.
- The reinforcement of public regulation and sanctions.

Regarding disclosure requirements, firms now have to disclose any corporate governance arrangements, non-routine transactions³⁰, the whole compensation of board members including their stock options. They also have to mention whether they comply with the national corporate governance code (we discuss below) following the *comply-or-explain* principle. Since 2002 (effective in 2006), they make their financial statements following IFRS norms.

Regarding the reinforcement of public regulation, French supervisory authorities have been merged into one single, the AMF – Autorité des Marchés Financiers (<http://www.amf-france.org/en>) in 2003. Criminal sanctions for market abuses have also been implemented since the 1970s in France (with a reinforcement in 1996), in addition

²⁹ AFG website (<http://www.afg.asso.fr/index.php/en>) states that “Le gouvernement d’entreprise [...] s’intéresse à la répartition des pouvoirs entre les diverses parties prenantes, notamment les organes de direction, le conseil (d’administration ou de surveillance) et les actionnaires, et vise à garantir l’équilibre des pouvoirs au sein de l’entreprise. [Il] recouvre donc les droits et les devoirs de la direction d’une entreprise vis-à-vis des autres parties prenantes, mais également les mécanismes dont disposent ces dernières pour contrôler les activités de la direction”.

³⁰ From 2001, revised in 2003 and 2005.

to the Market Abuses European directive in 2003 (tightened in 2005).

More recent reforms focus on the strengthening of internal governance mechanisms in particular on the board independence and composition. For instance, a 20%-rule (at least 20% of women on boards) by 2014, to be increased to 40% by 2017, has been set³¹. They also reinforce shareholders rights and especially shareholders' oversight over compensation. After the compensation proposal for the chairman-CEO of Renault, Carlos Ghosn, has been refused by the general meeting of shareholders (hereafter the GM) in 2016, the French Parliament included the *say-on-pay* principle into the Sapin II Act³².

In Europe, in addition to the national laws, national sets of "soft laws" (AMF, 2016) have been implemented since the 1990s, namely the national codes of corporate governance. They are partly the expression of the wish of the European Commission to progressively come to a convergence of national corporate governance policies. Nonetheless, they also express national specificities in terms of culture or history of corporate governance.

The French code, also called the AFEP-MEDEF code³³, displays several characteristics:

- Its application is not mandatory; it is only made of recommendations. Companies can derogate thanks to the *comply-or-explain* principle: either they comply with the code recommendations, or they can explain in their releases why they do not do so. The only mandatory rule (set by a European directive) requires any firm listed on a regulated market to display which code it is submitted to and whether it has decided to comply with it or not.

- There exists another code for SMEs, the MiddleNext code, published since 2009.

The revisions of the code are not regular but rather done in specific contexts (crisis, new European directives, etc). In particular, during the last two years, some new items or issues have been added to the diversity of board and committee members, compensation issues etc.

1.7.2. Ownership Structures of Companies

Contrary to the Anglo-Saxon world, ownership in Europe is usually concentrated in large shareholder's hands that are dominant in terms of control rights (e.g. has most of the votes) but not necessarily in terms of cash-flow rights. These controlling shareholders then have "both the incentive and the power" (Enriques & Volpin, 2007) to monitor the management. The main consequence is the emergence of a new type of agency issues between controlling (who become the agents) and minority (the principal) shareholders, instead of the usual shareholder-versus-manager conflict (Enriques & Volpin, 2007).

The main types of concentrated ownership are (Enriques & Volpin, 2007):

- Family control, where control is concentrated into one family's hands, most

³¹ According to an EY (Ernst and Young) report "Panorama de la Gouvernance en 2016", the 40%-threshold represents a real challenge for French firms especially for SBF120 ones. EY indeed forecasts that less than half of them should comply with the 40%-rule by the beginning of 2017.

³² AMF "Rapport 2016 sur le gouvernement d'entreprise et la rémunération des dirigeants". This new law acts as an anticipation of the revised European directive "Shareholders' rights" whose negotiation process is still pending.

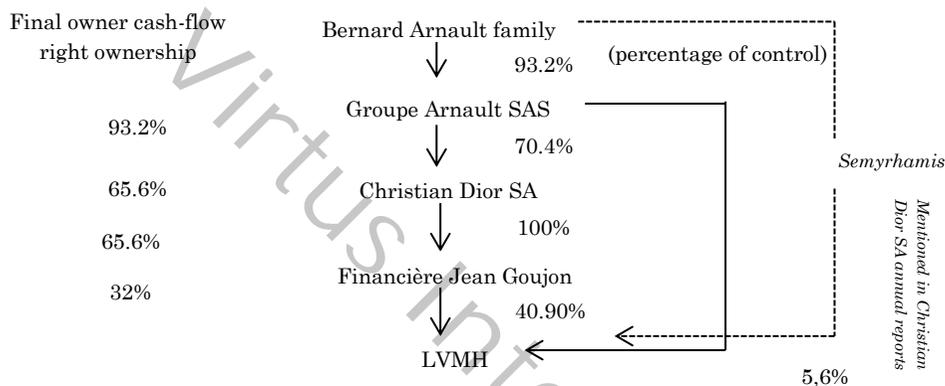
³³ This code has been first released in 2004 and gathers the recommendations of different reports made in 1995, 1999, and 2002. It is written by two associations that represents issuers (namely companies): AFEP (Association Française des Entreprises Privées created in 1982) and MEDEF (Mouvement des Entreprises de France created in 1998). Since 2013, the High Committee for Corporate Governance (HCGE in French) can also make proposals of updates and impulse debates related to corporate governance. Moreover, even it is written only by issuers associations, investors and their representatives can nonetheless be consulted for the redaction. (Source: AMF 2016 report "Etude comparée : les codes de gouvernement d'entreprise dans 10 pays européens").

usually the founder of the company.

- Pyramidal control “in which the controlling shareholder exercises control of one company through at least one other listed company”.

A good example of the pyramidal ownership structure in France is LVMH (<https://www.lvmh.com>). Its final owner is Bernard Arnault family who (ultimately) owns around 32.4% whereas the family controls 46.5% of LVMH thanks to the ownership of intermediary companies (such as Groupe Arnault, Christian Dior SA, etc) as Figure 1.7.1 displays³⁴. Moreover, additional intermediary structures, like Semyrhamis (Forbes, 2012), and specific types of shares regarding votes give even more control to the family and in particular to Groupe Arnault controlled by it³⁵.

Figure 1.7.1. LVMH ownership structure



Sources: Enriques & Volpin, 2007 and Forbes, 2012 Inside LVMH's Byzantine ownership structure.

The sole CAC40 index offers additional examples of « family businesses », namely firms controlled or ultimately controlled by the family thanks to a pyramidal structure: PSA group owned by Peugeot family through Etablissements Peugeot frères and the Société Foncière Financières et de Participations; Bouygues with the SCDM company controlled by Martin and Olivier Bouygues; L'Oréal group owned by the Bettencourt Meyers family; Kering owned by the Pinault family through the Société financière Pinault and Artémis; Sodexo in Bellon family's hands thanks to Bellon SA; and Pernod Ricard owned by the Ricard family through the Société Paul Ricard³⁶.

1.7.3. Market for Corporate Controls (M&A)

All takeovers are under the supervision of AMF, which applies national regulation in line with the European framework. Regarding takeovers, it especially monitors the information given to shareholders and the conformity of operations with the legal framework.

³⁴ Figures are for 2012, but Groupe Arnault controlled a quite stable percentage of LVMH between 2010 and 2016 (above 46%) (Forbes, 2012). Moreover, (Enriques & Volpin, 2007) 140 display a more or less similar structure in terms of ownership in their paper for 2005 (adding Semyrhamis and Financière Agache structures).

³⁵ According to the reference documents published by LVMH from 2010 to 2016, Groupe Arnault owned the following percentages of LVMH and of the voting rights: 47.64% (versus 63.66% of voting rights) in 2010, 46.48% (vs. 62.38%) in 2011, 46.42% (vs. 62.65%) in 2012, 46.45% (vs. 62.59%) in 2013, 46.57% (vs. 62.59%) in 2014, 46.64% (vs. 62.90%) in 2015, 46.74% (vs. 63.07%) in 2016.

³⁶ Information and all figures come from corporate websites as well as 2016 reference documents released by each company.

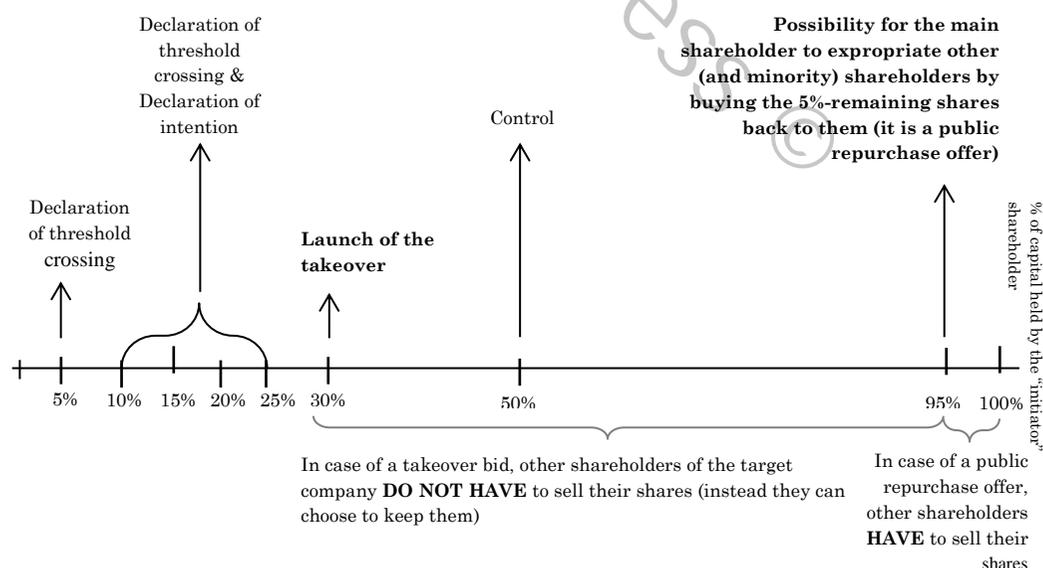
Shareholders of listed companies have to comply with specific requirements when the percentage of the capital they own goes above or below certain thresholds (see Figure 1.7.2). In particular, there exists a threshold of capital ownership above which the shareholder has to launch a takeover. In 2011, the regulator imposed shareholders to launch this mandatory takeover above 30% of capital holding (down from 33% before that). In other words, an investor who holds at least 30% of the capital of a firm has the obligation to set a takeover bid over all the other firm stocks. The purpose is to ensure minority shareholders a better protection (AMF, 2014). Furthermore, the Gallois report (2012) released a related proposal: lowering this minimal threshold of stock holding to launch a takeover from 30% down to 20% or 25% to limit even more disruptive takeovers (Gallois, 2012).

Figure 1.7.2 displays the rules implemented according to the different thresholds (AMF; www.lafinancementourtout.com).

Regarding more general assets sales or acquisitions, the mood also tends to a tightening of rules. There is actually no coercive regulation over assets sales and acquisitions: companies are not required to set a public offer/bid when they sell or purchase assets. Such operations thus legally depend on corporate law, which in France leaves much room to firms and set assets-related operations under the responsibility of managers and other management committees (with no obligation of shareholders consultation). The AFEF-MEDEF code only recommends consulting the shareholders assembly if assets sales or purchases represent a significant part of the whole corporate assets or activities (AMF, 2015).

However, a more tightened framework is considered in particular since the two big operations of SFR-Vivendi and Alstom in 2014. It may indeed ensure a better protection of shareholders and a more efficient management of their conflict of interests with firm insiders, especially thanks to a better information disclosure.

Figure 1.7.2. Takeover and disclosure thresholds



Consequently, in 2015, the AMF recommended to adopt the principle of consultation of shareholders when the company wants to sell at least a half of corporate assets³⁷. More specifically, it recommends to consult shareholders when at least two out of four specific ratios reach 50% over two years (the net sales of the sold assets relative to consolidated sales, the selling price of assets relative to the corporate market capitalization, the net value of sold assets, etc.). This recommendation has also been extended to significant assets acquisitions and more generally to the enhancement of information disclosure (especially on the motives of such operations) (AMF, 2015).

Mergers, as in any other country and in particular in the European community, are submitted to a much more tightened regulation, partly because of the anticompetitive effects that might threaten consumers' interests. In France, merger control has been implemented as soon as 1977, then revised several times in 1986, 2001, and 2008 (through the Modernization of the Economy act).

When the merger or any concentration project reaches certain thresholds especially in terms of total net sales, it falls under the control of either the European Commission (it is then said to be of "community dimension") or the French *Autorité de la Concurrence*³⁸ (then called of "national dimension"). The dimension of the concentration project depends on the thresholds. In the case of national dimension, the operation initiator has to require the *Autorité* authorization that can deny it if it expects the project to have anticompetitive effects (Autorité de la concurrence, 2015).

The examination and approval process is done in several steps (Autorité de la concurrence, 2015):

- Pre-notification, which is optional.
- Referral, either to the European Commission if the operation is of national dimension or to the *Autorité* if is of community dimension.
- Phase 1, which first consists in a formal notification. After that, the *Autorité* can authorize the merger; otherwise, the process steps to Phase 2.
- Phase 2, which ends up with the final decision, namely either the approval or the interdiction of the merger operation. One has to mention that the minister of Economy can require stepping to the phase 2, and can intervene when this step is processing.
- Appeals: all the decisions made by the *Autorité* or the minister of Economy can be appealed to the *Conseil d'Etat* (the French Administrative Supreme Court).
- Remedies: if some remedies have been required by the *Autorité* to offset expected anticompetitive effects, they are then implemented in that step.

³⁷ High Committee of Corporate Governance, 2016 annual report. It releases information over the period from September 2015 to August 2016. This committee has been created in 2013; its purpose is the follow-up of the application of the AFEP-MEDEF governance code along with the proposal of updates for this code. The sample of the 2016 report is made of 35 CAC40 firms and 105 SBF120 firms.

³⁸ Website: <http://www.autoritedelaconcurrence.fr/user/index.php?lang=en>. According to its 2015 annual report synthesis, the *Autorité de la concurrence* has three missions: "reviewing mergers", "punishing anticompetitive practices" (such as agreements or abuses of a dominant position), and "providing expert advice to the public authorities and economic stakeholders".

1.7.4. Board of Directors' Practices

Belot et al. (2014) provide an overview of the board structure in France and make the distinction between unitary and two-tier boards.

The former gathers in a single body the representatives of both managers and shareholders. Typically, in this case, CEO and board chairman functions are unified, but since the New Economic Regulation act in 2001, companies with a one-tier board are allowed to split both functions. Examples of such companies include LVMH or Bouygues.

By contrast, the two-tier-board structure implies the separation into two distinct boards:

- The supervisory board (the *conseil de surveillance*) is elected by shareholders and is in charge of the appointment of the CEO and other members of the management board, of their monitoring, and of the setting of the global corporate strategy.
- The management board (the *directoire*) is rather in charge of the day-to-day management.

Examples of such companies include in particular PSA group.

Belot et al.'s results show that among the founder- or family-controlled firms, the formers (unitary boards) are more likely when the CEO is part of the control group (what they call the "centralization of control"), whereas dual boards are more likely within firms with professional managers.

Table 1.7.1 summarizes the characteristics of these different types of board structures.

Table 1.7.1. Board structures – main characteristics

	<i>Unitary boards</i>	<i>Two-tier boards</i>	
		<i>Supervisory board</i>	<i>Management board</i>
Number of members	Between 3 and 18	Between 3 and 18	Up to 7
Mandate duration ³⁹	Max 6 years with possible renewal	Max 6 years with possible renewal	Between 2 and 6 years with possible renewal
Presence of managers	Yes in a limit of 1/3	No (not allowed)	Yes
Member independence ⁴⁰	No legal requirements	No legal requirements	NA
Committees ⁴¹	No legal requirements except for audit committees	No legal requirements except for audit committees	NA

Belot et al. provide an empirical study of these unitary-versus-dual structures and find that the choice of the structure within French firms depends on their characteristics. In particular, when asymmetry of information is higher companies are

³⁹ The 2016 annual report of the High Committee for Corporate Governance displays the following figures on the mandate durations of French firms (the sample includes CAC40 and SBF120 firms): in most SBF120 companies, mandates last either 3 or 4 years (in respectively 35.2% and 61.9% of them). The trend is even clearer in CAC40 firms as mandate durations perfectly split between 3 and 4 years (resp. 34.3% and 65.7%).

⁴⁰ Even though there is no legal requirement, unitary and supervisory boards of companies typically have between a third and a half of their members regarded as independent.

⁴¹ The missions of audit committees are determined by law. For other types of committees, there is no legal requirement, but companies most commonly have two more board committees in addition to the audit one: nomination and compensation committees.

more likely to choose a unitary board, which should be more manager-friendly and thus more likely to get information from executive officers. Conversely, when room for private benefits is greater, firms will most likely choose a dual structure, that it is shown to allow tougher monitoring, as the supervisory board (namely the monitoring part) will not look for information or any help from the management. Eventually, they find little evidence of a general effect of board structure over the firm value, meaning that dual boards (which imply stronger monitoring) do not result in a lower firm value.

An important aspect of French corporate governance (linked to board structures) is related to the separation of the CEO⁴² and the chairman⁴³ functions, which has also been allowed in unitary boards since 2001. Indeed, in 2016 in France, only 35% of CAC40 companies distinguished both functions, versus more than 90% of the largest firms in Germany, Italy, and the UK. Power dissociation nonetheless gains momentum as the referee board member⁴⁴ and the deputy chairman⁴⁵ got more powers (Ernst and Young, 2017).

However, when it is possible, national corporate governance codes in Europe (France, Italy, and Spain) mention the possibility of appointing a referee board member to act as a counter-power of the CEO-chairman. In France, the national code does not recommend him to be chosen among the independent directors or do not even define his functions (AMF, 2016).

Another field related to board that has been very much explored in theoretical and empirical literature is its composition⁴⁶. In particular, what are the optimal numbers of members, of employees, of women, of independent members, etc? What is the impact of its composition over firm value?

Ernst and Young provides an overview of board composition in 2016 (Ernst and Young, 2017):

- The part of women is increasing compared with 2015, to around 30% (34% for CAC40 companies, 33% for SBF120 ones, 27% for midcaps).
- The part of independent members is increasing too: 61% among CAC40 firms, 51% among SBF120 ones, 42% among midcaps.
- The part of foreigners is steady but with important gaps between larger and smaller companies: 31% and 24% for CAC40 and SBF120 (respectively) firms, versus 8% for midcaps.

Overall, EY report locates France at a good place compared with the UK, Germany, and Italy; in particular for the percentage of women (French firms of its sample have the greater percentage of women).

Employee representation in board also represents an important piece of the debate and is part of a more general question related to cultural differences between countries.

In France, employee representation begins in 1983 with an introduction in public companies (reinforced in 1986) (Bourjade, Germain, Lyon-Caen, 2016). In 2013 (via the

⁴² *Directeur général*

⁴³ *Président du conseil d'administration*

⁴⁴ *Administrateur référent* or senior board member

⁴⁵ *Vice-président du conseil d'administration*

⁴⁶ We do not provide an exhaustive literature review on this topic here, as this is not the purpose of the book. We rather focus on the legal framework on it along with an overview of today practices.

Employment Protection act), after the release of the Gallois report, the legal obligation is extended to all large companies (5,000 employees in France or 10,000 all around the world): such firms have to allocate at least one seat for an employee representative on their board (Bourjade et al., 2016) The Rebsamen act (2015) widens the scope of companies affected by this obligation (High Committee of Corporate Governance, 2016).

Moreover, the French commercial code sets the obligation to allocate seats to representatives of employee shareholders (High Committee of Corporate Governance, 2016)⁴⁷. The AFEP-MEDEF code also recommends the appointment of employee representatives on board committees.

To consider concrete figures, AMF reported that over the 62 firms of its sample, 16 of them had appointed in 2015 at least one representative of employee shareholders, and 29 of them had appointed a board member who was an employee but not a shareholder (AMF, 2016).

Board parity is also an important aspect of board composition. The increasing interest in this issue has led to the implementation of many new laws or recommendations all around the world. The evolution of the percentage of women on boards is homogenous across countries: while it used to be around 0% before the 1990s, in 2015, it is up to 40% of female board members within CAC40 firms, between 20% and 25% within FTSE100 and S&P500 ones (Bourjade et al., 2016).

In France, the Copé-Zimmermann act (2011) sets the legal obligation of allocating seats on boards to female members. Legal levels to be reached were 20% by 2014 and 40% by 2017 for companies (listed or not) that have more than 500 employees and whose total balance sheet or net sales are above 50 million euros (this number-of-employee threshold is to lower to 250 employees by 2020)⁴⁸. The law followed recommendations made by the AFEP-MEDEF code one year before (AMF, 2016).

France gets the best rank in the European Union, and AMF even reports an improvement within French boards: 35.2% of women on boards of the companies in its sample by the end-2015 (against 31.5% at the end-2014 and 28% at the end-2013) (AMF, 2016).

However, there is a gap between this improvement within boards and the part of women within executive officers: only 3 over the 62 firms of the AMF sample had appointed a woman as the CEO-chairman or CEO, 2 over 62 have appointed a woman as the chairman of the board at the end-2015 (AMF, 2016)⁴⁹.

Another recently well-debated issue is the independence of the board and especially the number of independent members relatively to top management. The presence of politicians on boards (and the resulting political connections of some companies) is a good example of the accuracy of such a debate. It is indeed a common practice in Europe for former politicians to exert a function in the private sector after

⁴⁷ The rule is that in listed companies, when employee shareholders hold more than 3% of the capital, shareholders have to appoint at least one board member who represents employee shareholders (unless one employee representative is already on the board) (Source: AMF "Rapport 2016 sur le gouvernement d'entreprise et la rémunération des dirigeants")

⁴⁸ The threshold of 20% in 2014 has been easily reached, but the 40%-level to be reached by 2017 might be more difficult to reach especially for mid-cap companies because they might lack of potential female board members (source: AMF 2016 report "Etude comparée: les codes de gouvernement d'entreprise dans 10 pays européens")

⁴⁹ According to the report, only 1.6% of its sample firms (respectively 0% of CAC40 firms) have a female CEO-chairman, 3.2% (resp. 2.8%) a female chairman, 1.6% (resp. 0%) a female CEO...

their political mandate(s); the most recent and discussed example is José Manuel Barroso, former chairman of the European Commission, who has been hired by the investment bank Goldman Sachs. It is as common in France: in 2017, for the first time, a former president, Nicolas Sarkozy, has been appointed to a board, the board of Accor hotels. In the framework of his new function, Nicolas Sarkozy will also be present at the committee for the international strategy that has been specially created. If the appointment of a former president on a board is the first time in France, other politicians have been hired by companies: Jean-Louis Borloo (beside functions at the Parliament, several times Minister in particular of the Economy and Employment) on Huawei board, Hubert Védrine (former Foreign Minister) at LVMH, Dominique Bussereau (Transport and Agriculture Minister) at CMA-CGM, Anne-Marie Idrac (Minister of State for Foreign Trade, and for Transports) at Total, Bouygues, Saint Gobain, and Aéroport de Toulouse. Even politicians' wives have been appointed too: Bernadette Chirac (former President Jacques Chirac's wife) at LVMH, Cherie Blair (former English Prime Minister Tony Blair's wife) at Renault⁵⁰.

More broadly, rules on board independence have been implemented since the 2000s and focus on the number of independent members on board, on the separation of the manager (CEO) and board chairman roles, and on the creation of specialized committees (on compensation, audit, nomination...) (Bourjade et al., 2016). This independence has indeed been recommended by the European Commission in 2005, which in addition sets a list of negative criteria to define it (and to be adapted according each national context). In France, such criteria are set by the corporate governance code but are not mandatory: instead, they follow the *comply-or-explain* principle^{51 52}. The AFEP-MEDEF code considers a board member to be independent when⁵³:

- He is not an employee, an executive officer or a board member of the firm or of a related firm (parent company, subsidiary, cross-shareholding, cross-board mandates, customer, supplier, a bank of the firm, through any business relationship...).

- He is not a relative of an executive officer.
- He has not been an auditor of the firm during the 5 previous years.
- He has not been an administrator of the firm for more than 12 years.

In 2016, AMF reports that there are a high proportion of independent boards within French firms (61% at the end-2015). Generally, most firms comply with the recommendation over declarations of conflicts of interests (whether one of their executive officers is appointed on the board of another company, over business relationships...). Moreover, audit and compensation committees have most of their members who are independent (in a proportion greater than three quarters, which is increasing from 2014 to 2015); most of them have also an independent chairman⁵⁴.

⁵⁰ *Challenges* "Un ex-président pantoufle à son tour" (published for March, 2th to 8th, 2017)

⁵¹ AMF 2016 report "Etude comparée : les codes de gouvernement d'entreprise dans 10 pays européens"

⁵² AMF "Rapport 2016 sur le gouvernement d'entreprise et la rémunération des dirigeants": in particular, it recommends companies to have at least 50% of independent board members when their ownership is dispersed and without controlling shareholders, and at least one third of independent members in more-concentrated-ownership firms. It also recommends that the compensation committee be chaired by an independent administrator.

⁵³ *Ibid*

⁵⁴ *Ibid*

Partly linked to board independence, the plurality of offices is limited⁵⁵. The Commercial code indeed states that an individual cannot have more than five offices as a board or supervisory board member of a public corporation⁵⁶ whose head office is located in France. The Macron act (2015) tightened this rule by preventing an individual who is also a CEO or a member of the management board of a big⁵⁷ listed company from having two offices as a board member. Both financial and monetary codes include other restrictions.

The recommendations of the AFEP-MEDEF code are even more restrictive: it recommends the limitation of the number of offices at five, including in foreign companies.

Besides board composition, compensation of its members is another important issue, which, in France, is regulated. Members can only be compensated through attendance fees and potential extraordinary compensations should they complete a specific mission approved by the board and the GM (for instance within board committees) (AMF, 2016), which is in line with the recommendations of the AFEP-MEDEF code. Furthermore, the French code recommends compensation rules (both attendance fees and individual amounts) to be displayed (High Committee of Corporate Governance, 2016).

Consistently, all firms studied by the High Committee for Corporate Governance in their last report actually display information relative to attendance fees. In addition, most of them display the rules relative to the repartition rule of attendance fees and the variable part (High Committee of Corporate Governance, 2016).

Even though there is no legal requirement on board committees, many firms do implement such committees in France, in particular, three of them: audit, compensation, and nomination committees. Consequently, it may be valuable to provide a brief overview of what was in place in France by the end-2015 (High Committee of Corporate Governance, 2016).

As the audit committees is a legal obligation, all firms do have one linked to their board or supervisory board. Similarly, all firms studied by the High Committee of Corporate Governance by the end-2015 have a compensation committee⁵⁸. Nomination (or selection and appointment) committees are often gathered with the compensation one, but in the same sample, all firms anyway have a nomination committee⁵⁹.

1.7.5. Executive Officers' Remuneration Practices

The 2008 crisis and the many scandals that arose about directors' remuneration and termination arrangements have brought debate on this issue as well as a reputational risk for companies⁶⁰.

⁵⁵ *Ibid*

⁵⁶ *Société Anonyme (SA)*

⁵⁷ Namely that employs more than 5,000 people in France and more than 10,000 people in the world.

⁵⁸ The AFEP-MEDEF code recommends that there is no executive officer on this committee. Moreover, in 2015, 55.5% (respectively 69.6%) of SBF120 (resp. CAC40) firms had an employee representative on it.

⁵⁹ For 30.5% (resp. 54.3%) of SBF120 (resp. CAC40) companies, it was distinct from the compensation committee.

⁶⁰ This reputational risk is now less important in France. Nonetheless, it remains difficult to quantify. (Source: EY report "Panorama de la Gouvernance en 2016")

Generally, the law requires the disclosure of executive officers compensation; more specifically, the Commercial code requires the total compensation as well as any benefits in kind paid to all executive officers to be displayed (AMF, 2016).

Moreover, the consultation of shareholders relatively to executive compensation has been introduced in 2012: it is the *say-on-pay* principle. The purpose is to communicate over directors' compensation, especially whether they have been in line with the firm strategy or their objectives, and over compensation criteria (EY report, 2017).

With the Sapin II act (2016), the following has become mandatory for all firms listed in France:

- An *ex ante* annual vote of the GM to approve (or not) the principles and the criteria of the compensation of all executive officers. In other words, now changing the compensation policy requires the GM approval *ex ante*. If the new policy is not approved, the board will have to submit a new one, while the former will keep being applied.
- An *ex post* annual vote of the GM to approve (or not) compensations that have been paid for the previous year to executives, in particular, the variable part of this compensation.

The main difference is now that both votes are binding and no more consultative⁶¹. The High Committee of Corporate Governance even recommends the board to require an approval rate (of executive compensation) of at least 70 or 80%.

Compared with the European level, French law goes beyond the Shareholders' Rights directive, whose negotiation is still processing. In particular, the Sapin II act requires two binding votes per year.

To this legal framework, the French code of corporate governance also adds recommendations, in particular on the variable part of compensations. It indeed suggests that they are not only based on financial (or quantitative) criteria but also on non-financial (or qualitative) criteria (AMF, 2016).

Other rules have been implemented on the use of shares and stock options that are distributed to executive officers as part of their compensation. Regarding the exercise of executive stock options, the Commercial code indeed states that the board has to either decide that they will be able to exercise the options only when they are not in function anymore or fix the number of stocks that executive will have to keep after options are exercised. Since 2013, the AFEP-MEDEF code has recommended that main executive officers should be required to keep a certain number of shares (fixed by the board or the supervisory board). These retained shares can come from either option exercises or performance stocks (High Committee of Corporate Governance, 2016).

An issue that is well-debated as well is linked to termination arrangements that are the causes of many corporate scandals in the 2000s. In particular, the same code recommends the setting of maximum amounts of termination arrangements at the equivalent of two years of compensation (including both fixed and variable parts) (AMF, 2016).

⁶¹ The binding aspect of the *say-on-pay* principle has been highlighted with negative vote of Renault and Alstom shareholders to the proposal relative to the compensation of their respective CEO-chairman.

By the end-2015, most firms studied by AMF in its annual report included a variable part in their executive compensations (93% of all firms of the sample, and 97% of the ones listed on the CAC40). Moreover, most of them complied with the recommendations in terms of termination arrangements (AMF, 2016).

Regarding the structure of the compensation within the same companies (AMF, 2016), almost all executive officer compensation included a fixed part (and almost 30% of them experienced an increase in this part). Figures on the variable part of compensation are more mixed: at the end-2015, 89% of executive officers of the sample firms earned a variable part (increasing compared with 2014), but almost all firms had at least one executive officer who earned a variable compensation (steady compared with 2014) (AMF, 2016).

The criteria that are chosen to determine the amount of the compensation are of two types (AMF, 2016):

- Quantitative criteria are used by all firms and rely on free cash-flows, operating income, ROCE (return on capital employed), growth in sales, change in EBITDA.
- Qualitative criteria are used by most of them (90%) and are related to the firm strategy, managerial quality, firm ESR (environmental and social responsibility). EY finds that the most used qualitative criteria are the decrease in the carbon footprint and in the use of energies in firm operations along with the improvement in the performance in the health and security at workplace (29% of firms), ethics (17% of them), and the innovation and the development of a series of sustainable products and services (11%) (EY report, 2016).

1.7.6. Shareholders' Rights Protection

Enriques and Volpin (2007) provide a list of shareholders' rights:

- The right to sell their shares.
- The right to sue; even though such a right depends on the easiness and the cost of suing in a given country.
- The right to say, namely to act on corporate governance issues.

In particular, to increase shareholders' voice, several measures can be (or have already been) implemented. First of all, the number of subjects to be approved by the GM may be increased especially to include any "non-routine transactions with a major shareholder" and for specific types of executive compensations⁶². Decreasing costs of voting may also participate in an increase in shareholders' rights, in particular through online vote or facilitations to vote.

In particular, minority shareholders' rights are better and better protected thanks to different measures: specific majorities are required to approve special (namely "non-routine") transactions⁶³, decrease in the minimum ownership threshold for minority

⁶² Through the mandatory *say-on-pay* rule (see Section 1.7.5 of this chapter).

⁶³ The requirement of the GM approval for non-routine transactions is part of a more global trend that tends to enhance the control of all transactions made by managers and controlling shareholders.

shareholders to exert their rights (especially to call a meeting, ask for an expert...). Further improvements may limit deviations from the one-share-one-vote to prevent controlling shareholders from keeping multiple-vote shares and thus keeping control while not representing the majority on the GM. Minority shareholder representation or super-majority to approve specific topics may also be required.

Among the measures that may improve shareholders' rights protection that have not been discussed yet, the question of "non-routine" (Enriques & Volpin, 2007) or related-party transactions has been considered by the AMF. In particular, it recommends that if the firm A is a shareholder of the firm B and the individual C a shareholder of the firm A, neither firm A nor individual C should participate in a vote of a transaction made by the firm B that may ultimately be beneficial for the individual C. In line with this recommendation, the Sapin II act (2016) requires that any regulated contract between a firm and one of its executive officers need for both board and shareholder approval (AMF, 2016).

The possibility of double voting rights has also been discussed to protect the long-term shareholders. In 2012, one of the proposals of the Gallois report (Gallois, 2012) is to allow companies to focus more on long-term perspectives. To do so, it proposed to automatically give a double voting right to shareholders after two years of stock holding: the Florange act implemented the measure in 2014.

More measures have been implemented on other issues (for instance on board-related ones) but also participate in the protection of shareholders' rights:

- The first of them relates to board independence⁶⁴. Indeed, the more independent from top management the board is, the more it will act in shareholders' interests. In particular, if it is highly independent, it will protect better shareholders from traditional agency issues that arise from the separation of ownership and control.

- The *say-on-pay*⁶⁵ rule is also about enhancing shareholders' rights protection as it gives increasing powers to them, in particular, the possibility to influence executive compensation (allowing thus to better monitor or incentivize managers accordingly), the overall requirement to be consulted over more topics, and the possibility for them to impose their decisions.

At the European level, a directive called "Shareholders' rights" is even being discussed (discussions were still processing by the end-2016) (AMF, 2016). The main purpose is to give more power to shareholders and make interests between investors, managers, and issuers converge, especially on board member compensation and related-party transactions. So far, the following items have already been discussed: the reinforcement of shareholders' rights of access to information and of vote, transparency over and vote of executive officers compensation (a European version of the *say-on-pay* rule), a better control of related-party transactions⁶⁶.

⁶⁴ For a more detailed discussion of board independence, see Section 1.7.4 of the present chapter. Moreover, on the global issue of conflicts of interests, see the AMF "Rapport 2016 sur le gouvernement d'entreprise et la rémunération des dirigeants"

⁶⁵ For a more detailed discussion of the *say-on-pay* rule, see Section 1.7.5 of this chapter.

⁶⁶ The issues that are discussed in this directive negotiation process are much similar to what has already been implemented in France or is recommended by the AFEP-MEDEF code.

1.7.7. Shareholder Activism

Girard and Le Meaux (2007) define shareholder activism as “a process of contestation launched by one minority shareholder or a group of minority shareholders to improve either firm financial performance or its governance structure”⁶⁷.

In France, such a process occurs in several steps⁶⁸: (1) informal meetings to reach an agreement, (2) other public (and more offensive) actions towards the public opinion, other shareholders or stakeholders, (3) “proxy battle” to get the majority of voting rights, and (4) share sales by initiating shareholders or legal battle. The questions addressed through this process more and more include topics such as corporate social responsibility and now overall corporate ESR (environmental and social responsibility) issues⁶⁹.

Moreover, shareholder activism also depends on cultural habits and on the legal framework. In particular, Civil law countries such as France are showed to less protect minority shareholders; for instance, because of too high minimum thresholds to exert their rights such as calling a meeting, too long share deposits to speak at GMs, impossibility to vote electronically... (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998).

French shareholder activism has evolved since the 2000s and can now be split into two types (Girard & Gates, 2013): the usual shareholder activism conducted by short-term-view institutional investors, and the “shareholder commitment” which is longer-term oriented and include in its criteria non-financial and in particular ESR aspects (Girard & Gates, 2013)⁷⁰.

Many of the rules already implemented or recommended result from (or even participate in) shareholder activism in two ways: by guaranteeing an increasing transparency over management decisions and actions, and by increasing shareholders' decisional and coercive powers (AMF, 2007).

For instance on the transparency issue, the legal framework guarantees an increasing disclosure of all corporate governance arrangements, non-routine transactions, board compensation. Even the disclosure of financial statements has been normalized and now has to be done following IFRS so that the understanding is eased and more information is displayed. Similar rules exist on executive compensation and on takeover bids and all types of market controls⁷¹.

The increase in decisional and coercive powers of shareholders is at least as important as the transparency issue, as it encourages them to exercise their voting rights. The *comply-or-explain* principle, for instance, participates in this insofar as it gives more voice to shareholders who, to some extent, require justifications from top

⁶⁷ Girard, C., & Le Meaux, J. (2007). De l'activisme à l'engagement actionnarial. *Revue Française de Gouvernance d'Entreprise*, 1, 113-132. “l'activisme actionnarial se définit comme un processus de contestation [...] engagé par un actionnaire ou un collectif d'actionnaires minoritaires pour améliorer soit la performance financière de l'entreprise critiquée soit son système de gouvernance”

⁶⁸ For a detailed description, see Girard, C., & Gates, S. (2013). *L'Evolution de l'activisme actionnarial en France au cours des deux dernières décennies*. (Working paper). Retrieved from the World Wide Web : <https://hal.archives-ouvertes.fr/hal-00853366>

⁶⁹ For more details, see Section 1.7.9 of this chapter.

⁷⁰ A good example is that now more and more investments funds include ESR criteria in their choices of investment.

⁷¹ For example, there exists an obligation of disclosure of threshold ownership (see Section 1.7.3 of the chapter).

management over their decisions. Similarly, the *say-on-pay* rule is also a way to reinforce shareholders' protection and consequently to enhance their potential activism as they now have a real decisional power over executive compensation. More generally, the recent legal framework has driven to a strengthening of all internal governance mechanisms⁷²; and a more frequent use or recommendation of the consultation of shareholders⁷³; the reinforcement of minority shareholders rights and powers being a specific case of these phenomena⁷⁴.

1.7.8. Corporate Governance and Firm Performance

Many empirical researches have been conducted to examine whether corporate governance affects or not (and positively or negatively) firm performance. In particular, some studies have focused on specific issues of corporate governance linked to the board⁷⁵.

Studies of the impact of employee representation on board find that such a presence positively affects shareholders. In France, Ginglinger et al. (2011) show that if employee representation on boards does not affect firm value or profitability, employee shareholder representatives do have a positive impact over it. In their theoretical investigation, Germain and Lyon-Caen (2015) find that specific levels of employee representation on boards may increase the firm value and make it more oriented towards long-term perspectives.

However, empirical results on the parity topic (does the presence of women on boards enhance firm value?) are more mixed, in particular over the relationship between firm performance and board diversity.

As we previously discussed, board independence is more and more crucial. It is considered to help decreasing agency issues between shareholders and managers by appointing board members that are less advocated to executive officers and whose interests are more aligned with shareholders' ones⁷⁶.

Again on that topic, empirical results are mixed. On the one hand, they show that a greater independence acts more in favor of shareholders (accordingly to the decrease in agency conflicts). But on the other hand, they do not provide a clear link between independence and value for shareholders.

Bourjade et al. (2016) justify these mixed findings by several reasons. First, the independence of a board member is difficult to assess and even to define, especially if one considers crossed or multiple mandates (of board members as well as of executive officers), personal and family networks, social networks of the elite in particular in France (for instance, ENA graduates)... The second difficulty is related to the endogeneity problem: while the impact of board composition over firm performance is

⁷² A good example of this is the strengthening of board independence (see Section 1.7.4).

⁷³ For instance, consultation of shareholders over big corporate asset sales (see Section 1.7.3).

⁷⁴ For instance, in 2001, the lowering of minimum thresholds (from 10% down to 5%) to make a proposal to a GM, the authorization of electronic votes...

⁷⁵ In the paragraphs that present empirical results, we will mostly focus on France-related studies.

⁷⁶ Bourjade et al., provide an overview of the findings trying to correlate board independence and firm performance.

much studied, it may be interesting to ask whether this is not rather the latter that affects the former. Finally, firm performance is determined by many other factors than the single governance quality and in particular the number of independent board members.

Regarding the impact of ownership structure on firm performance, empirical studies usually show that family-controlled firms are better managed than the widely-held ones: for instance within companies from continental Europe, Barontini & Caprio (2005) observe a higher performance within family-controlled firms.

Indeed, family control may yield positive effects: shareholders' interests are more protected⁷⁷, firm strategy and shareholders' perspective are longer-term oriented. This nevertheless creates a new type of agency issues, between the family that is the controlling shareholders (equivalent to the agent) and other shareholders (equivalent to the principal) (Enriques & Volpin, 2007).

On the overall ownership structure, empirical studies bring more conflicting results that well illustrate both positive and negative affects ownership type can have on firm performance⁷⁸.

Finally, regarding the overall shareholder issue, an interesting finding comes with Gompers et al.'s (2003) study. They indeed construct a "Governance index" based on shareholders' rights and find that stronger shareholders' rights imply better corporate performance.

1.7.9. Corporate Social Responsibility

Corporate social responsibility is an increasing topic of interest that was initially set by shareholders' preferences and activism (through for instance their choice of ESR-involved companies).

The main point through which a company is regarded as ESR-involved is obviously the range of products or services it offers (are they socially and environmentally sustainable?). But it is also a subject that is more and more discussed within boards (EY report, 2017) and other frameworks, and impact many other aspects of corporate lifecycle and activities. EY indeed provides clear figures to support it. According to their report:

- 55% of CAC40 boards had discussed it in 2016 (which represents an increase by 10% compared with 2015);
- Among boards that have discussed it, 26% did through a committee solely dedicated to ESR, 35% regard ESR issues as a compliance requirement, and 39% regard them as a strategic corporate issue.

ESR has even been added as a non-financial criterion to the variable part of numerous executive compensations⁷⁹. It covers various topics as carbon, health, and

⁷⁷ Usually managers are members of the family and thus also shareholders, which reduces the traditional agency issues between shareholders and managers.

⁷⁸ Demsetz & Villalonga (2001) well show this possible compensation of both opposite effects, and find that ownership structure has no impact over firm performance.

⁷⁹ For more details, see Section 1.7.5 of this chapter.

safety at the workplace, ethics, innovation and sustainable offer, employees' involvement, ranking in extra-financial indexes⁸⁰.

If the increasing interest in ESR partly comes from shareholder activism, it also results from a more and more coercive legal framework on the topic. Indeed, in France, by the end-2015, several laws already regulate corporate behavior and information disclosure relative to ESR (AMF, 2016):

- The New Economic Regulations act (2001) as well as the Grenelle I act (2009) aim at regulating the disclosure of non-financial (especially social and environmental) information by listed companies.
- The Grenelle II act (2010) extends the information to be published to societal issues along with the scope of companies that have to release such information. It also makes mandatory for listed firms to display a list of 42 items linked to ESR.
- The Banking and Financial Regulation act (2010) cancels the possibility for employee and stakeholder representative institutions to discuss ESR-related information that is released.
- The Warsmann IV act (2012) implies to release two distinct lists of information and exceptions regarding subsidiary firms whose parent company already publishes a consolidated report.

After 2015, the Energy Transition for Green Growth act (2015) adds other requirements such as the report of financial risks that result from global warming and corporate actions to curb them. It also extends the information that has to be displayed in ESR reports: companies now have to include discussions about their commitment to "circular economy", and about the consequences of global warming over corporate activities and good and services firm consume. Besides, the Fight against Food Wasting act (2016) requires companies to include information on that topic in their ESR report (AMF, 2016). There also exist legal rules set at the European level such as the ESR directive (AMF, 2016).

In addition, AMF recommends to improve ESR-related information and even to explain it more in corporate ESR reports. It also makes recommendations relative to *green bond* issuance (in particular in terms of communication around their issuance), to the discussion of social and environmental risks, and to the exact definition and explanation of ESR criteria used in executive compensation (AMF, 2016).

Overall, French companies obviously comply with such requirements and even go beyond this legal framework, as most of them set more long-term-oriented objectives, use clearer and more and more relevant ESR indicators, and release both financial and non-financial information. Consequently, even if there is room for further improvements, all French firms have increased the time and the efforts allocated to ESR (in particular in terms of time of discussion, allocated resources, development of new tools, etc.) (AMF, 2016).

⁸⁰ Such indexes are good examples of fields which corporate social responsibility covers, along with of shareholder activism. They are indeed more and more asked by investors (both institutional and individual ones). A good example is sustainable-based indexes like the DJSI (Dow Jones Sustainability Indices).

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